Print This P

COVID-19 impact: Bumpy road ahead for Indian economy, global financial markets

Mazhar Mohammad

Even before COVID-19 struck the world, the global economic output was on a decline with some expecting that a recession was in the offing. GDP numbers revealed that many countries including advanced economies peaked in 2017, the US being an exception as sustained growth continued till 2018.

Contrary to the real economic indicators, financial markets, especially, the equity asset class was defying the reality and making new lifetime highs with bloating valuations. The pandemic broke this illusion as many developing markets crashed witnessed massive portfolio outflows which resulted in severe depreciation of local currencies against greenback thereby enhancing the cost of servicing their dollar-denominated debt.

Country	GDP growth % in 2017	2018	2019
USA	2.4	2.9	2.3
Germany	2.8	1.5	0.60
UK	1.9	1.3	1.4
China	6.9	6.7	6.1
India	6.5	6.7	5.3

It is obvious that when the global economy is on a slowdown mode no emerging economy can grow at its normal pace. Moreover, the Indian economy was grappling with its own issues and COVID-19 made the matters worse.

India's GDP has been on a consistent decline after peaking out at 7.9 in Q4 of FY 2018 to 4.5 in Q2 of FY 2020. The industry was facing demand problems, due to which business houses were reluctant to undertake capex plans, unemployment was at its peak and exports which were consistently down for several months.

The impact of the slowing economy was augmented by the pandemic which led to a contraction of around 35 percent in March as all geographical boundaries across the world were closed due to lockdown. Hence, going forward, some individual sectors of the economy can take a big hit.

Sectors such as auto, which accounts for about 10 percent of the GDP and employs around 40 million people, was on a consistent decline marked by dwindling sales quarter-on-quarter. Recent numbers released by SIAM suggest that sales hit a two-decade low in January 2019. With lockdown and loss of income, discretionary consumption is likely to a hit for a couple of quarters. Hence, it may pose a big challenge for many auto companies to retain the workforce at a time when they are already in a deep slump.

Before the pandemic, Banking and Financial services was facing massive problems with the collapse of IL&FS, DHFL and Yes Bank fiasco. Private Banks, NBFCs and even Micro Finance Institutions which were aggressively building their retail loan book may come under severe pressure if businesses across the board witness massive layoffs. Moreover, as these portion of loans are completely unsecured, there can be a slew of defaults especially on MFI side and can also bring the mid and smaller NBFC's to the brink of collapse.

Some of the new age digital financial start-ups which simply opened the liquidity tap to trap the young earners with huge interest rates may be forced to shut shop. More clarity in this regard will emerge only after 3 – 6 months when the economic activity resumes (hopefully). Meanwhile, credit take off can be low for the next couple of quarters as companies rework on their capex plans due to weak demand and uncertain global environment.

IT which plays a key role in the Indian economy may not remain immune to the crisis as they secure a major portion of their business from Europe and North American countries which are badly impacted by COVID -19. They may see reduced orders not only from BFSI segment but also from sectors like retail, aviation and other tourism-related businesses which may get severely impacted. Moreover, if talk of de- globalisation or localisation of businesses gain traction in post COVID world, then this sector will be the first to get severely impacted raising the fear of job losses.

Tourism, which accounts for roughly 9 percent of the GDP, may decimate at least for next 2-3 quarters. Aviation which contributes around 2.4 percent to GDP will also be severely impacted. These sectors employ 42.7 million people combined.

Though online businesses may be facing difficulties now due to supply chain constraints, they may emerge among the few beneficiaries if the sentiment and practice of social distancing continue after the pandemic.

Are debt crisis brewing in emerging markets?

The pandemic on the back of an already slowing economy may prove to be lethal for developing countries as mentioned above. Moreover, the US is reluctant to assume global leadership under Trump administration who is inclining for 'America first' policies. China with its high growth rate and 16 percent share in global GDP can assume the leadership role but western countries are sceptical about it due to the political and ideological difference.

According to recent report released by United Nations Conference of Trade and Development developing countries piled up a debt which is expected to be 193 percent of their GDP by the end of the year 2018 which was up from 100 percent to GDP in the year 2008.

It expects over $1.62 trillion sovereign debt maturing by 2020 and another $1.08 trillion by the year 2021. Moreover, according to UNCTAD estimates, due to COVID -19, these developing countries are expected to lose export revenue of $800 billion at a time when their currencies are taking a massive hit due to sharp fall in the financial markets. This has enhanced the cost of servicing their dollar-denominated debt. In normal times, this kind of debt may get rolled over but now all economies are struggling to meet their own ends. Hence, if any of these countries default then it may trigger debt crisis sending the global financial markets into a tailspin which may again delay the recovery process for the global economy.

(The author is Chief Strategist – Technical Research & Trading Advisory at chartviewindia.in)